RESEARCH HIGHLIGHT

November 2006

Socio-economic Series 06-021

Structural Analysis of Montréal's Real Estate Market

INTRODUCTION

The housing market in Quebec and in Montréal (metropolitan Montréal) has been exceptionally dynamic since the start of the new millennium. In the middle of the 1990s, there were fewer than 8,000 housing starts annually within metropolitan Montréal. Since 2002, this number has reached more than 20,000 units annually. In addition to the rise in housing starts, housing prices have also increased significantly in recent years.

CMHC recently commissionned Daniel Arbour & Associates to prepare a report comparing developments in new and existing housing prices and rents in Canada's three large urban centres of Montréal, Toronto and Vancouver. This research highlight summarizes this report, then addresses explanatory factors. Thus, the report deals with the economic context and then documents the changes in housing demand as a function of the demographic characteristics and pressures that affect demand. This report also addresses the supply structure, looking at the composition of the housing stock as well as the nature of the past 30 years of growth.

PURPOSE

The main purpose of this project is to analyze the structure of the Montréal real estate market to determine whether it has undergone any structural changes by addressing changes in indicators such as, the economy, demography, housing, etc. The analysis is partially informed by the situation in other Canadian markets and focused on the scope of and reasons for change. The research therefore serves to identify these changes and their scope, and makes it possible to determine whether change is temporary or permanent, and to identify impacts on the housing market in coming years, specifically with respect to prices.

DEFINING THE CONCEPTS

The idea of structure rests on the time invariance of certain market characteristics. Structure is composed of all of the most invariant and permanent characteristics of the market which supply it and give it existence. However, the research objective is to analyze economic, demographic and real estate changes to identify structural changes.

Thus, it could be said that structural changes correspond to movement in the characteristics that define equilibrium, leading to a shift in this equilibrium.

On the other hand, it can be said that cyclical changes correspond to the fluctuation of certain characteristics around a given equilibrium, without changing it.

Structural change may occur gradually (for example, economic changes such as economic tertiarization, which corresponds with growth in the services sector) or suddenly (for example, as the result of a specific event such as a policy change or new legislation). In the latter case, this could be called a structural shock.

Canada

CMHC SCHL
HOME TO CANADIANS

SUMMARY OF RESULTS: MONTRÉAL REGION

Prices of existing homes

Since the beginning of the 2000s, a rather steep increase in the price of existing housing has been observed, particularly in the luxury segments; in other words, for two-storey luxury homes, two-storey detached homes and luxury condominium apartments. Prices for premium detached homes began increasing in 2000. Construction of this product reappeared during the 1980s housing boom, but it experienced marked growth during the most recent economic expansion.

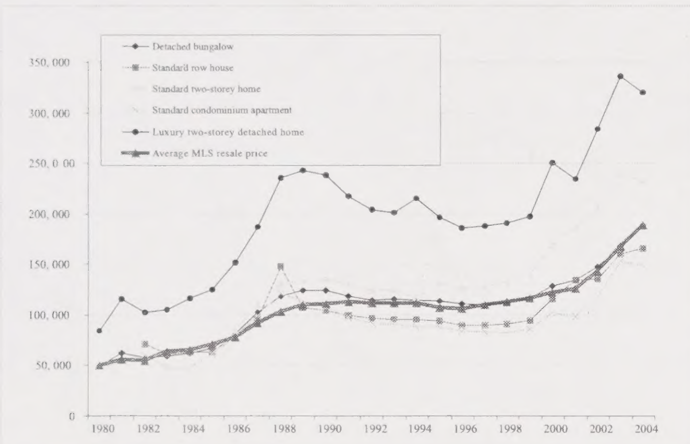

Figure 1 – Changes in average resale prices in the metropolitan Montréal region, 1980-2004

Figure 2 – Average resale price adjusted for inflation, 1980-2004

Sources: Royal LePage (authorized use and publication of data)

Canadian Real Estate Association (Multiple Listing Service)

In Montréal, specifically downtown, luxury condominiums intended for clients, such as investors and foreign residents, have grown substantially. A second aspect of this phenomenon is the large luxury homes responding to a need that emerged during the latest upswing in the real estate market. In both cases, these are niche markets and their rapid growth should be followed by a period of slow production, which is already perceptible.

Once the price index (CPI) has been subtracted from the average MLS prices, it can be noted that the recent growth, in good part, served only to

reestablish the 2001 real prices at their 1989 levels, because they had dropped during the 1990s.

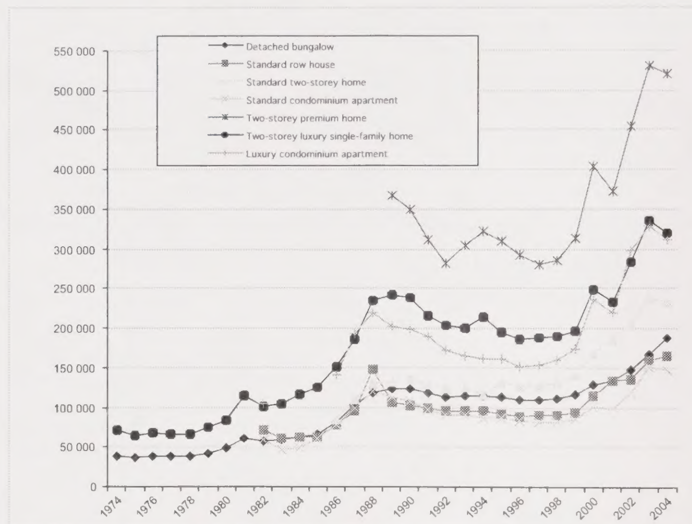

Figure 3 – Changes in average resale prices by housing type in the metropolitan Montréal region, 1974–2004

New home prices

Between 1984 and 1988, the Montréal price growth followed the growth observed in Toronto and Vancouver. Beginning in 1989, this growth slowed and the prices remained fairly stable until 1999, when they began a period of marked increase. In 2003, the gap between average prices in Montréal and Toronto hovered around $100,000, a gap similar to that observed in 1984. With correction for inflation, it can be noted that the average price in Montréal decreased in real terms during the 1990s, until 1998.

After the rise that began in 1999, in 2001 the average real price of detached and semi-detached homes regained its 1990 level, which was approximately $150,000.

It is possible that the new niche for the construction of luxury properties may have exerted some upward pressure on the average price; we have only to think of certain sectors of the West Island, Laval and Blainville, and on the South Shore such as Brossard and Candiac, to name but a few.

Unlike what was observed on the Toronto and Vancouver markets, prices in the Montréal region were not characterized by sharp variations, whether up or down. The variations are progressive and marked by slowdowns. The general shape of the curves depicted on Figures 1-3 makes it possible to predict that periods of higher growth are cyclical.

Luxury and premium detached homes

This report finds that the phenomenon of new luxury and premium detached homes, which is poorly measured, is a response to a specific local demand. These are niche markets and their rapid appearance should be followed by a period of decreased production.

Luxury condominiums

Since 2000 there has been rather strong growth in the luxury categories. The Montréal market, particularly the downtown, has experienced a strong increase in luxury condominiums intended specifically for a segment of investment clientele and foreign residents with high incomes. Moreover, the same group of individuals who built the suburbs in the 1970s and 1980s are now taking over the luxury condominium units for a return to city life once the children leave the family home.

These are niche markets and their rapid appearance should be followed by a period of decreased production. But some of these niche markets are vulnerable. This is the case with suburban homes of $250,000 and over, and luxury condominiums of over $250,000 in the downtown. There is a surplus of higher-priced detached homes and condos, which will result in a drop in the market for these products in the coming years.

Rental housing

Average rent did not increase significantly in Montréal when inflation is taken into account for the period. In 2002, the average real rent returned to its 1991 level, at approximately $500 monthly. On the other hand, during the same period, the real monthly rent continued to grow, both in Toronto ($875) and Vancouver ($800). Since 1990, the difference between Montréal and other regions has been increasing.

ECONOMY OF THE GREATER MONTRÉAL AREA

In the early 1990s, the Canadian economy was experiencing slow and even negative growth. The Canadian economy in general and Quebec's economy in particular were radically reoriented as a result of open borders and the penetration of new production and communication technologies. Traditional sectors (textile, clothing, shoes, furniture, milled wood, pulp and paper) which employed thousands of workers, experienced difficulties. New sectors were emerging, associated, among other things, with new information technologies.

In Montréal between 1971 and 2001, employment only grew by 66.7 per cent, from 1.0 M to 1.7 M jobs. Employment growth was greater in Toronto and Vancouver. New job creation in Toronto was two times greater than in Montréal between 1996 and 2001, with 351,505 and 176,345 new jobs respectively.

An industry analysis shows that, as in most Western economies, the amount of activity in the tertiary (service) sector in Montréal increased, to the detriment of the primary (agriculture, forestly & mining) and secondary (manufacturing) sectors.

In 1971, 27.8 per cent of jobs in Metropolitan Montréal were in the secondary sector. In 1996, this proportion was only 18.2 per cent. During the same period, the primary sector remained relatively stable at approximately 0.7 per cent of jobs. The relative share of jobs in the tertiary sector rose from 71.4 per cent in 1971 to 81.1 per cent in 1996. Economic tertiarization is a well known and observable phenomenon in Metropolitan Montréal.

Changes in characteristics: 1997 and 1998

In the service sector, commerce has the greatest proportion of jobs (more than 16 per cent). But professional, scientific and technical services and business services, building-related and other support services experienced the greatest increases between 1987 and 2004 (123 per cent). The number of jobs in the health care and social assistance sector also increased during this period; the most notable increase was observed between 1998 and 2004 (49 per cent). Over the same period, business, scientific and technical services increased by 35 per cent to corner the sector with the 4th greatest job concentration.

Salaries associated with the emerging technology sector in the Montréal region are also above the national average and those observed in Toronto and Vancouver,[1] whereas salaries associated with labour intensive sectors, which are declining sharply in Montréal, are below the national average and those of Toronto and Vancouver.[2] The transformation of Montréal's manufacturing sector should have an influence on average salaries but perhaps even more on consumer housing preferences.

During the 1990s, the commodity production sector, specifically manufacturing, declined and then rebounded in the mid-1990s as a result of the growth in electronic and pharmaceutical companies. On the other hand, in the Montréal region, the manufacturing sector is dominated by labour-intensive industries which, despite a relatively significant downturn between 1976 and 1997 (from 44 per cent to 30 per cent of jobs), were still dominant at the end of the period. The most significant increase in jobs occurred in the technology industry, whereas the greatest drop was recorded in labour intensive businesses.

A relatively sudden change seems to have occurred after the short 1995 recession. In 1997 certain sectors grew significantly, for example, the professional, scientific and technical sectors grew by 35 per cent.

HOUSEHOLD INCOMES

The average income for Montréal households is less than for households in Toronto and Vancouver. The gap has increased both nominally and on an inflation adjusted basis.

In 1971, the average income for Montréal households was 82.9 per cent of that for Toronto households and at 99.5 per cent for households in Vancouver. In 2001, this gap grew to 70.3 per cent and 85.3 per cent respectively for Toronto and Vancouver. The median income follows exactly the same trend, but there is a less marked increase in the median for Montréal households compared to households in other regions due to the fewer high paying jobs.

Similarly, between 1996 and 2001, growth in the median household income was less than that of average household income. Montréalers' average income increased by 20.5 per cent, whereas median income increased by 16 per cent. This difference shows an increasing trend in the income gap.

This difference in the income gap between Montréal households and other metropolitan regions is attributable to the changes in household structure in these three regions.

The average number of people in the labour force per household is much lower in Montréal than in other metropolitan areas, at 1.28 people per household in Montréal in 2001, whereas there were 1.41 people in the labour force per household in Vancouver and 1.57 in Toronto. In 1971, these ratios were 1.38 in Montréal, 1.40 in Vancouver and 1.63 in Toronto.

[1] 1.07 in Montréal versus 1.00 for all of Canada, 1.02 in Toronto and 0.88 in Vancouver in 1997.
[2] 0.89 in Montréal versus 1.00 for all Canada, 1.07 in Toronto and 1.05 in Vancouver in 1997.

DEMOGRAPHY

The rate of labour force participation for female family members between the ages of 25 and 44 is on the rise and jumped between the 1996 and 2001 censuses. Labour force participation for women with children more than doubled between 1976 and 2004 (37.1 per cent to 80.7 per cent). There was also an increase of more than 15 points in the percentage of childless female family members. This figure grew from 72.6 per cent in 1976 to 87.7 per cent in 2004.

In addition, between 1976 and 2004, there was an increase in the proportion of families with children in which both parents worked. More specifically, the proportion of families with at least one child under six years of age, with both parents working almost tripled, from 24.7 per cent in 1976 to 67.6 per cent in 2004. Similarly, the proportion of dual parent families in which both parents are employed and whose youngest child was between 6 and 15 years of age almost doubled during the same period (37.5 per cent in 1976 compared to 71.9 per cent in 2004).

RENTAL HOUSING STOCK

The rental housing stock in Montréal is much larger than in Canada's other two large metropolitan regions and the differences in the composition of this stock are particularly significant. In 1971, two thirds of Montréal units were available for rent whereas in Toronto and Vancouver this proportion was between 42 per cent and 46 per cent.

The production of new housing dedicated to access to homeownership and to a certain degree, the conversion of existing units into condominiums, modified this proportion in the three regions. In 2001, it is estimated that 50 per cent of units were available for rent in the Montréal region, whereas the proportion of units for rent in the other two regions dropped below the 40 per cent mark (Toronto 37 per cent).

In this respect, Montréal has broken a historic record. Traditionally tenants, a majority of Montréal households have now become homeowners. Given the strong trends in housing production, this proportion will continue to increase.

AFFORDABILITY

It is less costly to acquire new or existing property—either a house or condominium apartment—in Montréal than in Toronto or Vancouver. This is demonstrated by the analysis contained in the report, which compares the affordability ratio[3] for acquisition of a standard new or existing home, or a standard condominium apartment, in the three metropolitan regions.

The affordability ratio for a Montréal household was 24 per cent in 2002 to acquire a new home, 19 per cent for an existing home and 15 per cent for a condominium apartment. In the Montréal region, these rates have been relatively constant since 1996, notwithstanding the increase in average house prices during the same period.

These affordability ratios are much lower than in Toronto. Toronto's affordability ratio for acquiring a new home fluctuated much more, to reach 27 per cent after a gradual drop in prices in the region. For an existing home, the Toronto rate is 28 per cent, and 18 per cent for a condominium apartment.

In Vancouver, the affordability ratios were greater than Toronto's, at 53 per cent for a new home, 35 per cent for an existing home and 17 per cent for a condominium. When the affordability ratio is analyzed on the basis of average income, Montréalers have a clear advantage over residents of Canada's two other largest urban centres.

When changes in the affordability ratio are analysed, using a 5 per cent fixed mortgage rate, the affordability ratio required by a household or a person to buy a property has barely increased.

The affordability ratio for property acquisition experienced a slight change in the most recent growth period. Beginning particularly in 2002, this change indicates that house prices have increased slightly more rapidly than household incomes for this period.

[3] The affordability ratio required is the proportion of the average household income or individuals with adequate income to repay a loan over 25 years at a fixed mortgage rate of 5 per cent covering 100 per cent of the average sale price of a typical property.

WILL THESE CONDITIONS PERSIST AND MAINTAIN THEIR PRESSURE ON HOUSING PRICES?

The forecasts for household growth made by the Institut de la statistique du Québec [Quebec statistics institute—ISQ] for metropolitan Montréal presented in the report indicate a gradual drop in the creation of new households. The average number of new households should go from 20,300 between 2001-2006, to 19,300 between 2006-2011, and to 18,100 between 2011-2016.

On the one hand, immigration levels depend on job growth; net migration has hit a plateau, and there has been a negative balance for interprovincial migration since 2001.

At a rate of 24,300 new housing starts in 2003, the annual supply of new homes already exceeds ISQ predictions for household growth by 20 per cent.

Therefore we can expect:

- an increase in vacancy rates for rental housing
- a drop in the production of new homes
- gradual price stabilization.

On the other hand, the Montréal population will continue to age in step with the baby boomer generation. Currently, baby boomers dominate the market and according to the forecasts they will continue to do so for the next 15 to 20 years.

This is a significant long-term demographic change, demonstrated by a dominance of people 45 years and over after 2000, unlike the dominance of the 25-39 years of age in the 1980s. This change has already had a significant effect on the residential market, the type of production, the location of projects and housing prices.

SUMMARY AND CONCLUSION

The housing market in Quebec has been exceptionally dynamic since the start of the new millennium. In the Metropolitan Montréal region, vacancy rates hovered at 1 per cent, prices were constantly increasing in all segments, housing starts doubled compared to 1999 and construction costs also continued to grow.

Using a comparative approach, changes in market conditions over recent years in Toronto, Vancouver and Montréal were analyzed to determine whether the recent changes that have been observed are structural or cyclical, temporary or permanent, and to identify their impacts on the housing market in the years to come.

The average price of a detached bungalow home in Montréal varied between 50 per cent and 60 per cent of the Toronto average between 1974 and 2004. The mean value was 54 per cent of the average Toronto price.

From a financial point of view, acquiring a new or existing property, whether a house or a condominium apartment, is easier in Montréal than in Toronto or Vancouver. The mortgage affordability ratio for a Montréal household fluctuated around 24 per cent for a new home, 19 per cent for an existing home and 15 per cent for a condominium apartment. In Toronto, the affordability ratios were higher: 27 per cent for a new home, 28 per cent for an existing home and 18 per cent for a condominium. In Vancouver, the affordability ratios were also higher, at 53 per cent for new homes, 35 per cent for an existing home, and 17 per cent for a condominium.

There is still a gap between average household incomes in Montréal and other regions. The average income for Montréal households is lower than in Toronto and Vancouver. The difference in value grew both nominally and corrected for inflation. In 1971, the average Montréal household income was 82.9 per cent of Toronto's and 99.5 per cent of Vancouver's. In 2001, this margin grew to 70.3 per cent and 85.3 per cent respectively, which is attributable, in part, by changes in household structures in the three regions.

Furthermore, Montréal's economic structure has been transformed similarly to the rest of the North American economy (tertiarization). Growth in the trade sector did not slow; it includes the greatest proportion of jobs (more than 16 per cent of all jobs). The job structure in the service sector has changed over the years. In Montréal's economy, the size of the professional services, scientific and technical, and health care and social assistance segments has continued to grow.

Industrial structures were affected in a different manner by the changes in Canada's economy, with Montréal's relative share of the manufacturing sector dropping between 1976 and 1997. In this sector, Montréal's economy is still dominated by jobs in the labour-intensive industries, although their relative share has decreased significantly. This tends to keep salaries low. On the other hand, Montréal's economy has been more favourable to industries in the technology sector.

Unlike Toronto and Vancouver, price changes in the Montréal region were not marked by sharp variations up and down, but were progressive, punctuated by slower periods. The general shape of the curve implies that the periods of stronger growth correspond with cyclical demographic and economic changes.

According to the research, the recent jump in Montréal region's housing prices results from an adjustment to the supply in response to pressure from the expanded number of households formed by the greater number of youth between 20 and 24 years and, to a lesser degree, by the increase in divorced people. This pressure was accentuated by a favourable economic context and the employment growth which resulted in an increase in immigration to the region.

The abundant and affordable supply on Montréal's rental housing market allowed groups such as youth to quickly fulfill their housing needs. However, the low production in rental housing could absorb only a portion of this pressure. The supply of vacant rental housing was filled, and vacancy rates reached less than 1 per cent (0.6 per cent).

Finally, the drop in interest rates encouraged property access and kept housing prices at an affordable level despite an increase in selling prices, in both resale and new construction. In the notable absence of availability on the rental market, pressure on the property market grew. The overheated real estate industry encouraged concentration of producers in the most lucrative, high end niche markets.

CMHC Project Manager: Bruno Duhamel, in cooperation with the Quebec Market Analysis Centre and the Société d'habitation du Québec

Consultants: Daniel Arbour & Associates

Housing Research at CMHC

Under Part IX of the *National Housing Act*, the Government of Canada provides funds to CMHC to conduct research into the social, economic and technical aspects of housing and related fields, and to undertake the publishing and distribution of the results of this research.

This fact sheet is one of a series intended to inform you of the nature and scope of CMHC's research.

To find more *Research Highlights* plus a wide variety of information products, visit our website at

www.cmhc.ca

or contact:

Canada Mortgage and Housing Corporation
700 Montreal Road
Ottawa, Ontario
K1A 0P7

Phone: 1-800-668-2642
Fax: 1-800-245-9274

Printed in Canada
Produced by CMHC 05-12-06